

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:EC
PLR-122815-06

Date:
September 1, 2006

Legend

Corporation =

Date X =

Dear :

This letter responds to your request, dated January 31, 2006, for a ruling on the Federal income tax consequences under section 83 of the Internal Revenue Code of a cancellation of certain nonlapse restrictions. The facts represented by Corporation are as follows.

All of Corporation's shareholders are employed by Corporation and are party to a buy-sell agreement with Corporation and each other. The agreement was amended, effective on Date X, after Corporation established an employee stock ownership plan ("ESOP") under sections 4975(e)(7) and 401(a).

Prior to the Date X amendment, the buy-sell agreement prohibited the transfer of shares to anyone other than Corporation without the consent of Corporation's shareholders. The agreement further required Corporation to purchase a shareholder's stock at book value and permitted Corporation to pay for the stock in installments over a three (3) year period, with interest calculated at prime rate.

Under the buy-sell agreement as amended on Date X, Corporation is required to purchase a shareholder's stock at appraised value, rather than book value. The amended agreement further provides that Corporation is permitted to pay for the stock in installments over a 10 year period if the shareholder becomes disabled, dies or retires, and over a 15 year period if the shareholder terminates employment before age 65 or divorces. The amended agreement specifies that the interest rate on installment payments made by Corporation to departing shareholders is the short-term applicable Federal rate established from time to time pursuant to section 1274(d), adjusted

monthly. The amended agreement further permits retiring shareholders to sell their shares to the ESOP. Other restrictions on stock transfers found in the original buy-sell agreement remain in the amended agreement.

Corporation represents that it has not taken and will not take any compensation deductions related to the Date X amendment. Corporation further represents that no shareholder is required to perform additional services to receive appraised value for his or her shares.

Under section 83(a), if, in connection with the performance of services, property is transferred to any person other than the person for whom the services are performed, the excess of (1) the fair market value of the property (determined without regard to any restriction other than a nonlapse restriction) at the first time the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over (2) the amount (if any) paid for the property, shall be included in the gross income of the person who performed the services in the first taxable year in which the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable.

Section 83(d)(1) provides that, in the case of property subject to a nonlapse restriction which allows the transferee to sell the property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property, unless established to the contrary by the Secretary.

Under section 83(d)(2), if, in the case of property subject to a nonlapse restriction, the restriction is cancelled, then, unless the taxpayer establishes (A) that the cancellation was not compensatory, and (B) that the person, if any, who would be allowed a deduction if the cancellation were treated as compensatory, will treat the transaction as not compensatory, the excess of the fair market value of the property (computed without regard to the restriction) at the time of the cancellation over the sum of (C) the fair market value of the property (computed by taking the restriction into account) immediately before the cancellation, and (D) the amount, if any, paid for the cancellation, shall be treated as compensation for the taxable year in which the cancellation occurs.

Section 1.83-5(b)(1) of the Income Tax Regulations provides that the determination of whether there has been a noncompensatory cancellation of a nonlapse restriction under section 83(d)(2) depends upon the particular facts and circumstances.

Based on the facts represented by Corporation, we rule that:

(i) the changes to the buy-sell agreement pursuant to the Date X amendment do not represent a compensatory cancellation of a nonlapse stock restriction under Code section 83(a), and

(ii) the sale by a retiring shareholder to the Company or ESOP under the agreement as amended on Date X would not be a compensatory cancellation of a nonlapse stock restriction under section 83(a).

Except as specifically ruled on above, no opinion is expressed as to the Federal tax consequences of the transaction described above under any other provision of the Code. This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

William C. Schmidt
Senior Counsel, Executive Compensation Branch
Office of the Division Counsel/Associate Chief
Counsel (Tax Exempt & Government Entities)